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Summing up of the discussions on regional autonomy

by Prof. M. Sadli¹

We have heard a lot of complaints, supported by surveys of credible research institutions, of new taxes, user charges (*retribusi*) and other levies, by provinces, districts and municipalities (*kabupaten & kota*) in the two years of implementation of the laws on regional autonomy. Many of those charges are levied on trade or on the movement of commodities in or passing through the territory. Such levies are depicted as having distortive effects on the economy. They hamper the free flow of goods within national borders, an important economic policy principle to be upheld.

The central government has tried to roll them back in 1997 by Law no.18, but after the implementation of the laws on regional autonomy in 2001, they are coming back, although not always legitimate, i.e., in accordance with Law no.34/2000.

Apart from charges on transportation of goods there are also reports of exactions on enterprises by local governments, ostensibly as user charges, such as contributions for street lightings, even when the electricity is produced by the companies themselves. The practice of demanding “third party contributions” by local governments is also a new cost increasing phenomenon making the affected enterprises less competitive or less profitable. According to a survey done in 55 *kabupatens* by the research institute of the economics faculty of the University of Indonesia (LPEM), such charges since 2001 can amount to up to ten percent of costs and impose a relatively heavier burden on smaller establishments. Other surveys, reported today at this conference, however, concluded that the impositions weigh more heavily on larger enterprises. Hence it is still not easy to form a firm conclusion.

Perception surveys also bear out that most companies do not report a large change in impositions as compared to the situation before the year 2001. There are even respondents who perceive a slight improvement of the business climate after the implementation of regional autonomy. Whatever the direction, lighter or greater burdens, the changes are marginal (below 0.5 on a scale of 2).

Bert Hoffman, the chief economist of the Jakarta office of the World Bank, has said earlier this year, that “the implementation of the laws on regional autonomy in Indonesia has created great new fiscal and administrative problems and confusion but has not caused a major calamity”. What he meant was, in the realm of public administration and finance, the transfer of some two million central government personnel to regional

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entities and the transfer of a significant part of central government expenditures to local governments have not wrecked the system. The minister of finance has been able to control the deficit in his budget, the growth of money in circulation has been properly managed by the Bank Indonesia and the inflation has abated in the year 2003.

The rate of growth of the economy has dropped from a post-crisis peak of about 5% in 2000 to levels between three and four percent per annum. The figure has been relatively stable, showing even a very slight increase, from 2001 to 2003. The relatively high growth figure for 2000 has also to be seen as a recovery from a low point. In 1998 the economy contracted almost 14%; this contraction, however, stopped in 1999. Exports are still holding up (between \$55-60 billion annually), growing a bit from year to year, again the year 2000 being recorded as a peak after the very deep crisis in 1998. Only investments have remained the weak spot in the economy after tumbling heavily and becoming negative during most of the crisis.

The movements in macro-economic indicators may have been more influenced by macro-economic and international factors rather than by the implementation of the law of regional autonomy starting in 2001.

By putting a damper on the loud cries of complaints it is not the purpose to sideline them. The new taxes and charges may perhaps not have been excessive and for the time being most were absorbed by the enterprises and not fully passed on to the consumers or buyers of the products. The impositions have not “instantly killed the goose that lays the golden eggs” but perhaps, if not stopped, they will gradually starve the goose to death. The absorption of the additional costs by the enterprises has been documented in some of the surveys. But if profits are reduced so will be the capacity of the enterprises to expand by putting in more money. The distortive effects of the implementation of the regional autonomy laws may take a few years to materialize. We have to bear such in mind.

We have to look back at the efforts of the central government in the late eighties to “deregulate” (the word “liberalization” was at the time not so politically correct) the economy, and one of the efforts was to roll back the multitude of regional and local taxes and user charges (*retribusi*). The whole process of deregulation had effectively boosted the economy and made possible the boom of the nineties before being hit by the crisis.

Many of the local taxes and charges were also “nuisance taxes”, i.e., the cost of collection outweighing the gains. Many of the post *otonomi daerah* impositions are also nuisance taxes. When they are billed as “user charges”, no corresponding benefit to the user can be verified. Hence, once more, they should be rolled back.

This brings us to the problem of compensations. To give an incentive to the local governments to roll back their charges, or to give them some consolation, the central government has to enable them to receive more revenues. Such efforts have been made.

Important revenue taxes are mostly still collected by the central government but some part apportioned to provinces, districts and townships. Some are already directly

administered by the local governments. The local governments complain that the time lag waiting for their tax share from the central government is a big nuisance and that the verification is often not very transparent. Why not allow immediately direct collection of the taxes by the local governments? In time this may become practicable, but administrative capacity of new tax collection agencies cannot be built overnight. Moreover, there are two tiers of local governments, the province and the district. If later the *kecamatan* (sub-district) and *desa* (village) are recognized as legitimate tax collectors, this will add to the practical problems.

The tax basis for *desas* and *kecamatans* should be reviewed. A *desa* (village) is the home of mostly poor peasants or villagers living from non-farm income. Should they be taxed, how and how much? So far the central government is not collecting land tax from poor peasants, and sales or value added taxes are only imposed one time, at factory level on manufactured goods. Small eating stalls (*warung*) are not paying consumption tax paid by larger restaurants. In the old days the incentive to become *lurah* (village head) is that he will receive a piece of land from which he can live. But that depends whether or not the village still has spare land to give out. The *camat* (sub-district head) usually is a paid local government official. In one of the tables summarizing local levies imposed by *desa* and *kecamatan* officials appear significant in percentages of complaints (Indra N. Fauzi, REDI, paper, table on *Pelaku Pungutan Liar*).

Local collection of taxes will also not solve the problem of equity between regions. Most *kabupatens* are poor because they are rural. They have not much of a base for property taxes, vehicle registration taxes, consumption taxes on hotels and restaurants, even for billboard advertisement taxes. Only cities or *kabupatens* with a somewhat large capital city will have that potential. Then, perhaps, the provinces should perform such redistributational tasks.

Under pressure from the regions the central government has recently given in to tax revenue sharing of personal income taxes, i.e., twenty percent is allocated to the local government where the tax is collected. In practice that only profits large cities where many of the affluent residents live. Income taxes of companies should not be given the same treatment because only Jakarta, Surabaya and Medan will stand to gain, as companies operating in the regions and localities are paying income taxes at the cities where the companies are registered.

Most of the 350 or so *kabupatens* are rural and has no strong tax basis. Their local revenues (PAD) is often less than 10% of their budget needs. They will permanently depend heavily on central government transfers, and that should be recognized as a natural thing and nothing to be ashamed of. Instead of joining the present euphoria to increase PAD, they should instead concentrate on the efficiency and efficacy of their expenditures. The central government has insisted that budgetary planning should adhere to the principles of "performance budgeting". The practice of such should become also a topic of seminars on the implementation of the laws on regional autonomy.

The pressure for automatic tax revenue sharing is great. The regions producing natural resources were at the forefront. Aceh, Riau, East Kalimantan, Papua and others complain that for decades the central government has drained the rent from exploitation of natural resources (oil and gas, minerals, timber) for the benefit of Jakarta and the producing regions were at the short end of the redistribution. Most of it, they complain, went to Java on the principle that the benefits of natural resources should be enjoyed by all the people and that natural resources are the property of the nation as a whole, not of the local people. Accommodating such pressures and accusations the central government has agreed that some portion of the rent (i.e., government revenues above company income taxes *per se*) is to be directly shared by the people of the producing region. This revenue sharing has boosted the revenues of regions such as East Kalimantan, Riau and Aceh by over one trillion rupiah per year.

Other regions, such as West Java, then demanded that their most important resource, i.e., manpower (for industries), should count also in the tax sharing principle. Should regions be given a tax sharing of wages tax, or should the right of imposition of wage taxes be given directly to regions? At the moment Indonesia has no specific tax (with a once over collection at the source) on wages. It has a personal income tax of three tiers and with an exempted minimum. Factory workers are subject to this *PPh perorangan* for the part above the statutory minimum.

In the meantime, the General Allocation Fund (*Dana Alokasi Umum*, DAU) with a legal minimum of 25% of the total of domestic revenues of the government and now standing at about Rp 80 trillion (equivalent to about ten billion US dollars) is the most important variable in the fiscal equation. Because of budgetary limitations the amount of DAU is still very restricted but in the future this amount will grow in relative terms (percentage of government revenues) as well as in nominal amounts. Because of its size the DAU is the major instrument for fiscal equalization. The much smaller Special Allocation Fund (*Dana Alokasi Khusus*, DAK) of only some Rp 2.7 trillion is an additional instrument. The allocation formula will experience modifications over the years reflecting the search for a better, and more equitable, formula, but also reflecting the constant pressures of regions for a greater share. Regional lobbies in parliament are strong. Hence, such formula will never be ideally equitable.